RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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May 2, 1990 **LETTER 1042**

MARKETS: Once the bear has the market in his grip, I watch carefully and monitor the damage. And the damage has been widespread. Last week my PTI broke to a new low for the year confirmed with a new low in the advance-decline ratio (see page 2 chart). During the same week the following indices and items tumbled to 1990 lows: the NYSE, the S&P and the D-J Utility Averages, the NYSE and S&P Finance Averages, the AMEX value index and the Value Line Composite, and finally the London FTSE 30 (comparable to the Dow).

The Value Line Composite (1750 stocks on the NYSE, AMEX and NASDAQ) probably most closely mirrors the portfolio of the average person. Last week the Value Line wiped out all of its 1990 and 1989 gains plus part of its 1988 gains. Maybe that explains why the public has exited Wall Street and why a great silence has overtaken the brokerage houses.

At the same time, the bonds have been hit hard. Last week the June T-bond contract smashed through the 90 support level (taking the longer-term Treasuries to the 9.25% yield area). The T-bond weakness was confirmed by the June muni bond contract which tumbled below its 89 support level.

It's a confirmed bear market on Wall Street. Nevertheless, everyone wants guarantees, promises, confirmations and re-confirmations. At this point the Averages have a ways to drop before reconfirming the primary bear trend. To reconfirm the bear trend the Dow would have to drop below its January 2 closing price of 2543.24, accompanied by a Transportation Averages close below its own January 30 low of 1031.83.

However, Dow Theorists should remember this -- a trend remains in force until proved otherwise. The primary trend of the market was confirmed as bearish on January 25, 1990. The first or original confirmation of a trend has great authority. The major trend of the market remains bearish.

As far as the Utility Average is concerned, this bellwether Average has already provided its own bear market signals. The January low for the Utilities was 216.30. The Utilities have already plunged well below that level. It is perhaps ironic that so many "experts" advised moving into the Utility sector as a defense against the bear. The Utilities have been poor actors, and have already lost 12% of their peak January 2 value of 236.23.

As subscribers know, I've been depending heavily on my Primary Trend Index (PTI) to tell me what's going on in this difficult market. The performance of the PTI has been remarkable so far (and when I say remarkable, I mean remarkably helpful).

After dropping to a low of 3245 on February 23, the PTI rallied almost exactly to its moving average on March 19 (see page 2 chart). From there the PTI headed persistently down. On April 18 the PTI broke below its February 23 low, to record a new low for the year. The 89-day moving average of the PTI is now declining bearishly lower, and as of this writing the PTI is 58 points under its moving average.

For the benefit of new subscribers I will offer the following explanation. The PTI is my proprietary index. I make a point of telling my subscribers everything I think and know about the market and economy. So I blush to admit that I do have a single

Apr. 20 DJIA 2695.95; PTI 3226; A-D Ratio -11.15
Apr. 27 DJIA 2645.05; PTI 3213; A-D Ratio -12.02
Dow Yield: 3.90%; Dow P/E: 12.6; DowPow: 191
Dow Book Value: 1075; Dow 200-day MA: 2683
Percentage of Undervalued Blue-chips: 21%
PTI 89-day Moving Average: 3271

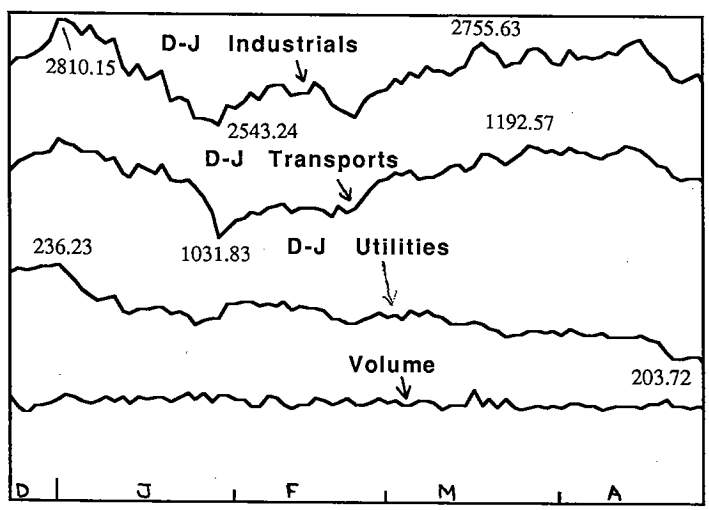
"secret". The one secret I have in this business is the make-up and construction of the PTI. I keep this secret only because if the construction of the PTI became public knowledge, I'm afraid that somehow it would lose its effectiveness.

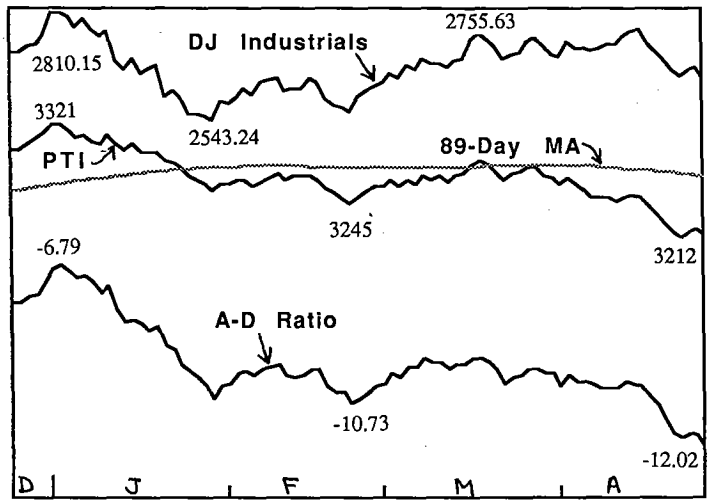
A chart of the Dow, the PTI and the A-D ratio appears on page 2 of every issue of Dow Theory Letters. But in this Letter (on page 2) I am including a point & figure chart of the PTI, a chart covering the action of most of 1988, all of 1989 and 1990 to date. This is a 4 x 12 chart meaning that each box represents four points on the PTI and only reversals (up or down) of 12 points or more are shown.

I'll be frank. I don't know what to make of this chart. If it was a stock, I'd sell it and be tempted to short it. But it's not a stock -- it's the PTI. What we see here is the PTI atop a "stilt" formation, a stilt which is 520 points high. Then we see a definitive "head and shoulders top" which was formed during 1989-90. The H&S top has been completed, and here in April the top has broken down.

What does this extraordinary formation mean for the market? First I should say that I have rarely seen this kind of perfect top formation in the PTI. To me, the picture certainly suggests major distribution. But the scary part is that giant stilt formation that is seen leading to the top. Is the PTI fated to correct part of the stilt? Is the whole stilt going to be wiped out? Or is the top formation going to extend, become more complex, become an even a bigger top?

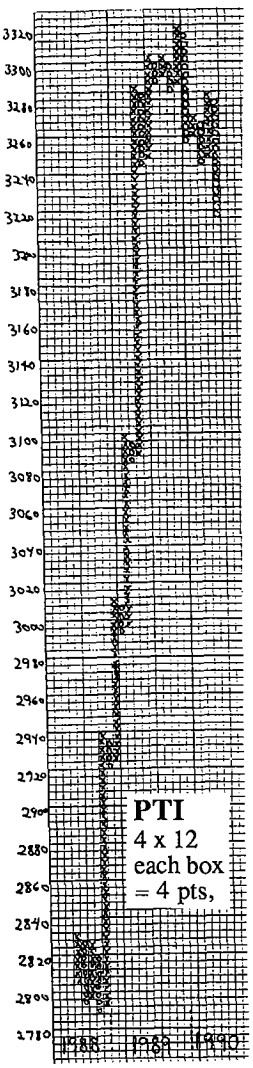
I wish I knew the answer. I wish I knew, but I haven't got a crystal ball and I'm not a psychic. So I say, "I consider myself lucky just to have the PTI." No other market device or index that I know of is presenting the picture that you see on this point & figure chart. Personally, I take it as a warning. This is a very bearish looking chart. It's telling me that the technical understructure of this market is deteriorating, and that the market could be under pressure (forgetting sporadic corrective rallies) for a significant amount of time.





Comment: Primary trends are always international in scope. In a bear market the damage will obviously vary from country to country, but the odds are that all nations will suffer, to some extent. Along these lines, each day I check the World Index which appears in the World Markets section of the *Wall Street Journal*. As you can see, the World Index is down 15.9% so far in 1990. Checking this index is a good way to follow the worldwide action of the bear.

	Apr 24	Apr 23	% This Year
U.S.	305.3	306.1	– 6.1
Britain	641.4	641.4	– 11.0
Canada	365.6	366.2	– 15.5
Japan	1247.1	1254.4	– 24.7
France	586.1	583.5	+ 3.4
Germany	295.1	296.7	+ 3.4
Hong Kong	2245.5	2276.9	+ 7.1
Switzerland	201.7	203.9	– 8.6
Australia	296.4	298.3	– 10.5
World Index	477.0	480.3	– 15.9



THE PICTURE: Bulls on the market present two major arguments: (1) There are "too many bears around," as measured by the number of investment advisors who are currently bearish (latest figure around 44% of investment advisors are bearish). (2) There is too much money sloshing around, and the funds and institutions have too high a proportion of their funds sitting on the sidelines in cash.

Frankly, I've been skeptical on both counts. The "too many bear" item has become too popular for my taste. Everybody is telling everybody else how bloody bearish everybody else is. I read it in the papers, I hear it on FNN, I read it in *Barron's*. I think the bull/bear consensus has become an indicator with far too wide a following. It's today's "in" indicator.

As far as all the cash that is sloshing around is concerned, I don't know what to make of this one. It reminds me of the old "shortage of stocks" thesis, which was so popular around the time of the 1987 crash. As far as I'm concerned, there's always enough cash around and there are always enough stocks around.

Stocks go up when there's a perception on the part of investors that future corporate earning are heading up. When that happens, cash appears as if by magic and stocks go up.

As far as any shortage of stocks (or bonds), when anything like a shortage appears, Wall Street will be only too happy to manufacture more. You want junk bonds, Wall Street will supply them. You want tax shelters, Wall Street will dream them up (at least, as long as the government allows them to). You want more common stocks, Wall Street will pull them out of its hat faster than you can say "new offering."

No, what I put credence in is the action of the market itself. I trust the action of the market because the market action tells me what is actually happening, not what other people may or may not think or what fund managers may or may not do.

ECONOMICS: People have heard about the debt/deficit problem for so long that they have turned numb (or immune) to the problem. I have been warning about the deficit/debt problem for so long that my subscribers are probably bored with it. **BUT THE PROBLEM REMAINS, AND IT'S GETTING A LOT WORSE.**

I blame our "caretaker" President Bush for his part in the problem. He's lied about the debt. He's never told the American people the awful truth -- that the US federal debt is increasing by $5.2 billion a week. I blame the Congress for the problem. They've been liars, and they've been derelict in their duty to the American people. They've never honestly addressed the debt/deficit disaster. They've spent too much of their time getting re-elected -- and spent little or no time addressing the gathering debt horror.

This is a headline from last week. The March federal deficit was $53.3 billion, $17.5 billion ABOVE the March '89 deficit. Business is not robust, and some sectors of the nation are in recession. Many corporations are showing losses, and will therefore not pay taxes. Individual tax refunds are running high. The government's expenses for bailouts are off into the wild blue yonder. And so is the federal debt.

$53.3 billion budget deficit sets record

United Press International

WASHINGTON — The United States suffered a record $53.3 billion budget deficit in March, soaring by nearly 51 percent over February's deficit of $35.3 billion, the Treasury Department said yesterday in its monthly statement.

In March 1989, the government ran a deficit of $35.8 billion.

Financial markets, which expected a lower deficit figure, in the range of $40 billion, reacted violently as bond and stock prices slid further. The normally routine announcement also caught many analysts by surprise.

"It's got to be in part a fluke," said Erich Heinemann, chief economist for Landenburg, Thalmann & Co. in New York. "This is way off the reservation. The underlying trends are not favorable."

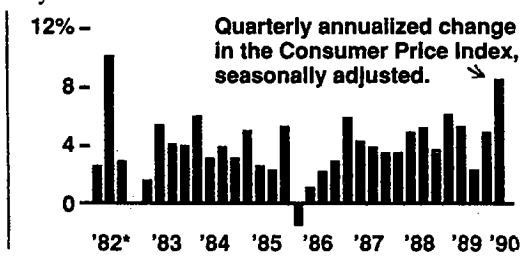
Two-thirds of the entire federal debt rolls over in the next five years, and much of it is rolling over in the next year or two. With long bonds at 9%, with bills at 8%, the interest costs to the government are going to rise significantly. This plus the compounding effect plus the addition of billions of dollars of new debt each week could mean (God help us) that the debt/deficit situation is starting to run out of control. It's literally taking on a life of its own.

If that happens, we're going to experience, well, I honestly don't know what we'll be experiencing, and neither does anyone else. It's unprecedented. It's debt going wild. Will rising debt give way to deflation? Will the Fed open the spigot wide (they're starting to do that now), and will they be able to pump us out of this mess? And if they do, will inflation run wild? Or will we have a mixture of inflation and deflation?

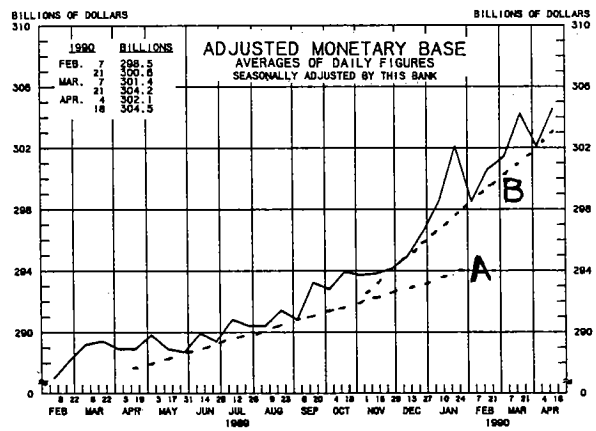
You know, there's one question that haunts me. It's this: in the 1930 during the Great Depression there was no question about the value of the dollar. The only question was how to get your hands on a few dollars. I know, I was there. I remember sandwiches at 15 cents and new Fords at $750 and jobs at $18 a week. Today there's plenty of money sloshing around, but nobody knows what the dollar will be worth a month from now or a year from now. The dollar is floating against other currencies, and it no longer has an anchor (it's completely detached from gold).

This presents a problem for investors. No longer can one simply "sell everything" and sit with dollars when danger strikes. You must diversify. If the debt monster goes "critical," I can't just tell my subscribers, "Sell everything and move into dollars or T-bills." It's not that simple or that clear any more. The only alternative is to diversify, to hold on to your house, your gold, your German marks, your T-bills, your jewelry.

Meanwhile, the charts are interesting. This chart shows that the quarterly inflation rate has jumped to an 8.5%, the fastest three-month rate in eight years. And this puts the Fed on the spot. Tighten credit to combat inflation? Ease up on credit in order to make it easier to finance the deficits? At any rate, don't envy Fed Chairman Greenspan. He probably doesn't know what to do any more than you or I do.



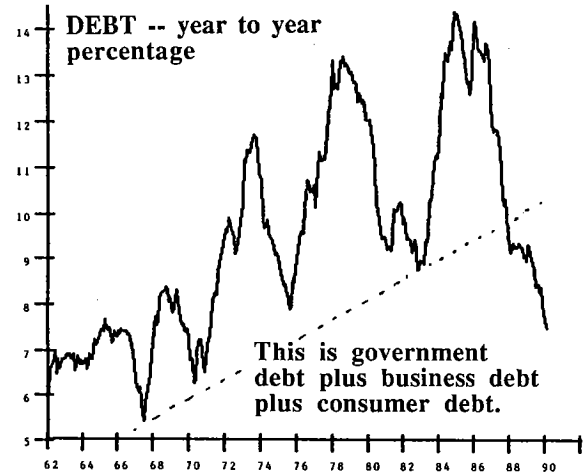
The next chart (courtesy of the St. Louis Federal Reserve Bank) tells a story worth heeding. Here's the adjusted monetary base, along with two trendlines which I have drawn. Trendline A traced the rise from May to December, 1989. Steeper trendline B traces the rise from September to the present. The actual compound annual rate of change is shown on the statistical roundup below. Note that from November 29 through April 4 the adjusted monetary base has risen at a rate of 8.9%.



This chart tells us that regardless of what Fed Chairman Alan Greenspan is reporting to Congress and the newspapers, the Fed is opening the spigots. In other words, "don't read Greenspan's lips, study the statistics."

In view of all this, what's been happening in the money markets? To put it bluntly, the bonds have been tanking. They're sinking (1) partly on the basis of the inflation news, and (2) partly because the Japanese have curtailed their buying of US bonds, and (3) partly because the US federal debt continues to rocket higher, and (4) partly because we have the making of a credit crunch, due to the banks pulling back sharply in providing loans, and (5) partly because large amounts of money have been going to Eastern Europe and the Far East.

Back to the question of why the Fed is opening the spigots. The Fed is trying to re-float the economy and is probably becoming quite worried about the sharp decline in credit demand. This chart (courtesy of Ed Hyman of C.J. Lawrence) illustrates what has been happening in the credit markets. We live in a credit-driven economy. When demand for credit slows down, the economy slows down. Says Hyman, "Major slowdown in credit demand had already started. Over the past year Debt has increased at the slowest pace in almost 20 years! And due to the pressure from regulators, debt growth is likely to slow to say 5.5% by year-end. Typically, a slowdown in debt is associated with a slowdown in the economy."



What we have at present are all the elements of a potential credit crunch. Possible scenario: the economy slows down. Many corporations, already in trouble, find that they need money in order to stay solvent. The banks, already suffering huge losses, turn even more conservative in their lending policies. In the meantime, the need for money becomes acute. The price of money (i.e., interest rates) rises sharply, and the crunch is on. The bond market swoons as interest rates explode.

What do we do if all this comes to pass? We look for an advantageous place to buy T-bonds -- and lock in fat interest income as well as potential capital gains. Why T-bonds? They are by far the most liquid bonds -- easiest to buy, and easiest to sell.

INVESTMENT POSITION: Treasury bills have been the star performers in 1990. Almost every other area from stocks to bonds have provided a negative return (euphemism for losses). I've been recommending T-bills for months, I've said that T-bills is where I have my own money, and it's T-bills where I'm staying, at least until the atmosphere clears.

Of course, T-bills are just a proxy for cash, although the bills do pay an attractive 8% (with no state taxes). For the benefit of neophytes, I should say that T-bills are the first debt obligation of the US Treasury. I recommend that you purchase them through a broker. You can buy bills directly through the Fed, but if you want to sell them before they mature it's complicated whereas through your broker they can be sold that day.

Last week two-year T-notes were auctioned off to yield 9%. Conservative reaction: "With two-year Treasury paper at 9%, who needs stocks?"

I continue to buy gold coins on a fixed-dollar amount -- once a month. I like the sight and feel of real money. Gold's fluctuations don't bother me at all. Here's an interesting thought: the world produces about $25 billion worth of gold each year. That $25 billion amounts to less than five weeks of US deficits.

TODAY: It's strange, but I sense in the attitude of investors and analysts today a certain frantic-ness. It's as if everybody is gripping the arms of their chairs, white knuckled and tense. The fact is that this business is getting progressively more difficult -- and competitive. Traders are being killed by whip-sawing markets, investors are uncertain about the trend, stock-pickers are confused, and the king of the value investors, Peter Lynch (of the Magellan Fund) has wisely left the field.

What, I have wondered, does Lynch know that caused him to say bye-bye to Wall Street at the age of 48? Lynch claimed he has been neglecting his family, which I don't doubt. But I'll bet it's more than that. I'll bet that Lynch sensed that the easy part of the cycle is over. And he wanted to exit as a hero -- at the peak of his power. Who can blame him.

In the meantime, we poor letter writers are left to struggle with the great monster that is Wall Street. I've been writing these Letters ever since 1958, and believe me, it doesn't get any easier.

So what do you do? What I do, and what I think everyone in this business has to do, is to develop a philosophy. If you don't, the markets will eat you up. They'll crush with their ornery-ness and their viciousness. I know. I've seen too many of my friends in this business go under -- one way or another.

The philosophy? Here's mine in a nutshell. "I do the best I can. I'm patient. I describe what I see, I say what I think, and I reveal what I'm doing." And I never try to play the genius. Playing the genius is the guaranteed road to ruin in the letter-writing business. First of all, there are no geniuses on Wall Street -- only survivors. Second, intelligent subscribers know there are no geniuses, and they distrust people who claim to be gurus. When I read an advisory the first thing I look for is humility. If a guy hasn't developed that trait, I know he's either a neophyte or a charleton. And I don't deal with either one.

NOTES & QUOTES: Inflation is accelerating world-wide. In the US, wages are rising at about a 5.5% rate, and in Japan, workers compensation (salaries plus bonuses) is rising at a 5% rate. The Japanese Consumer Price Index has been rising steeply (on a year to year comparison) ever since 1987. Those looking for world interest rates to come down may be whistling in the wind.

* *

The rest of the story: Mike Milken took the plea bargain route. Why? Government prosecutors, lined up against a huge battery of top-talent defense lawyers, weren't sure enough of their case. And Milken elected not to face the uncertainty of a jury (juries aren't always kind to billionaires), nor did he want to deal with the potential severity of the RICOH law. In recent months, Milken was paying legal fees of $1 million a month (a price he could well afford). Milken will pay a fine of $600 million, peanuts for him. Assuming Milken does not get a severe prison sentence, the general sentiment among legal experts is that Milken swung a sweet deal. The complaint: with no trial, we'll never know what really happened. Milken's secrets are safe.

* *

Congratulations Shearson Lehman Hutton. In the first quarter of 1990 they took a loss of $915 million, largest quarterly loss in the history of Wall Street. Personally, I thought the insanity started a few years ago when Shearson bought out E.F. Hutton with almost $1 billion in borrowed money. From there on, it was all down, down, downhill. By the way, talk about timing -- the Hutton buyout came at just about the height of Wall Street's good times.

* *

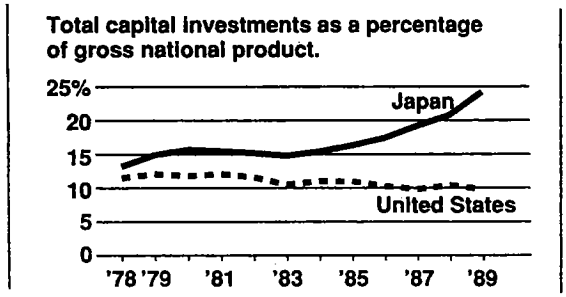
Speaking of trouble, San Diego is no slouch. Our own Great American Bank (the nation's eighth largest thrift) announced that during the last quarter of 1989 their "classified" (read doubtful) loans rose 59% , to $1.3 billion. Great American's future is now open to question.

* *

How easy is it to open up a business in Russia? Ask McDonald's. They spent 14 years and $50 million to set up their first hamburger outlet in Moscow. Furthermore, to insure a steady supply of quality products, McD runs its own Soviet farms, processing plants and delivery trucks.

* *

Here's a chart that is hardly encouraging. The Japanese continue to invest heavily in research, development and capital investments. This chart compares US and Japanese capital expenditures in percentages. Last year the Japanese invested $750 billion or 24% of GNP on plants, equipment, research and development. The US spent 10% of GNP or $500 billion on the same. Judge the future for yourself.



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With Trump's Taj Mahal casino in Atlantic City now open, it's interesting to see how Trump did the financing. Here are the facts: He borrowed $675 million via bonds and another $50 million from banks. He even borrowed the $75 million that he put up as his own equity against money he doesn't have yet. The Taj management will pay Trump 1.75% of the Taj revenue, provided the Taj has made interest payments first. So Trump borrowed everything to do the Taj deal. His risk is that if the Taj goes belly up, he's liable for the $75 million. The Taj will have to take in $1.2 million a day to cover the interest payments on all the money borrowed. Will it work? Who knows, but it shows what you can do if you have the nerve and the borrowing power!

Whoops, late developments. The April 27 *WSJ* reports about "Trumps growing appetite for cash," and states further that Trump "has discussed selling, refinancing or securitizing virtually every major asset he holds." Is Trump feeling the pressure or is he recognizing that a primary bear market is in force? Keep tuned, we should know before the year is out.

* *

Britain's trade deficit for March exploded to $3.59 billion. That set off talk of a rate increase, particularly in view of British inflation, which is heating up. When we were in London last summer I wrote that British prices were ridiculously high, and the pound was way overpriced. On a price parity basis I felt the pound was worth $1.25 (it was then around $1.80). The pound is now down to $1.62, and I still think its worth a buck and a quarter.

* *

The German Bundesbank will probably raise its rate, due to the issuance of all those new marks to East Germany. The Germans are probably more frightened than any other peoples by inflation, and they will take high rates rather than inflation. Watch for the Deutsche mark to become the leading world currency -- within five years or less (of course, that's only another Russell opinion).

* *

The following words were written by Abraham Lincoln. Mr. Bush and Congress should study this paragraph carefully. In my opinion, adhering to the advice presented in the next paragraph would cure all the ills that threaten the US today (the underlines are mine).

"You cannot bring about prosperity by discouraging thrift. You cannot strengthen the weak by weakening the strong. You cannot help the wage earner by pulling down the wage payer. You cannot further the brotherhood of man by encouraging class hatred. You cannot keep out of trouble by spending more than you earn. You cannot build character and courage by taking away man's initiative and independence. You cannot help men permanently by doing what they could and should do for themselves."

* *

In its cover story, "Detroit Under Siege" (April 14), the London *Economist* notes the following: "GM sells ten cars per employee, Toyota sells 45. GM still has 100,000 white collar workers in its US auto division alone, more than Toyota's total worldwide staff. Japanese factories in the US turn out cars for $700 less than the average Detroit (US-owned) factory. GM's centralized, bureaucratic ways make it too inflexible in a market in which the Japanese can produce new models every three years and can re-program their factories in a jiffy to respond to shifting demand. GM's committee-designed models are out of date years before they reach the streets. . . As recently as 1978 the Big Three made 82% of the cars sold in their all-important American market. Today they

have just 67% of American sales, a slide which most market analysts expect to accelerate in the next four years. Recently, all three companies lost money making and selling cars in North America, their core business."

"America's car firms have still not met the challenge of Japanese competition. Protectionism, management shake-ups and robots have all failed. Japanese factories in America are working flat out while America's factories face closures and losses. Ford's new boss, Harold Poling, Chrysler's Lee Iacocca, and GM's next chief Robert Stempel, must introduce huge changes if their companies are to survive the 1990s." So says the *Economist,* and their words have the ring of truth about them.

* *

The head of the Soviet's reform team, Leonid Abalkin, announced that the leadership has decided that ruble convertibility was not a possibility over the foreseeable future. Ruble convertibility is considered an absolute necessity if the Soviets are to even begin getting their economy in order. The Soviet economy, according to the *NY Times,* is now at the crisis stage and near collapse. Inflation continues to run wild with the government printing near-worthless rubles and the populace having nothing to spend the "money" on.

The CIA has all along maintained that the Soviet economy was half as large as ours and that the Soviets spent roughly 15% of their budget on the military. Enter the Russian economists. Victor Belkin of the Soviet Academy of Sciences claims that Russia's GNP is one seventh that of the America's. His associate at the academy, Yuri Dikhanov, says that Soviet consumption per person averages just 20% of that of Americans in 1985. Furthermore, new evidence indicates that the Soviets spend an outlandish and unsustainable 25% of GNP on the military.

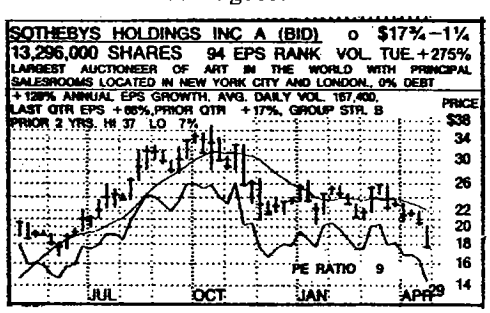
Gorbachev is currently running around the Soviets saying, "No shock treatment." Translation -- the Soviet people aren't ready for any drastic economic changes towards a free market. Russell comment: They may not be ready for the free market, but neither are they ready for the total mess the Soviet economy is now in.

* *

Want to make big money in sports? Easy, be a champion boxer. Sugar Ray Leonard led all sports figures this year with earnings of $27.4 million. Mike Tyson was second with $11.2 million. Roberto Duran was third with $7.6 million. Thomas Hearn was fourth with $6.9 million. Next? Drop way down with basketball player Patrick Ewing earning a mere $3.5 million. But wait, there are endorsements, and here the winners are the golfers. Arnold Palmer brought in $9 million in endorsements, Greg Normal $8 million and Jack Nicklaus $7 million plus. Next was tennis star Boris Becker with $7 million.

* *

Is the sky-high art market about to run into trouble? If you believe the action in Sotheby's stock, the trouble could be just over the horizon. This chart (courtesy of *Investor's Daily*) shows the value of Sotheby's being cut neatly in half. On top of that, Sotheby's is going partners in buying out an art collection -- cost over $125 million. S&P is skeptical and says Southeby's is acting as "a broker." S&P then put Sotheby's commercial paper on its "CreditWatch." And that ain't good.



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It is said that the luckiest businessmen during the 1930s were those who owned their own private companies. Why? The price of their stock wasn't listed daily in the newspapers, so they never had to face the terror of 70% and 90% drops in quotes. But there are other problems entailed in taking a company pubic. *INC* magazine this month publishes an instructive article on the problems of a public listed corporation. Here's an excerpt:

> Nobody wants to talk about what it's really like. For a reason. Few entrepreneurial dreams are as seductive as the one about taking your company public. It promises riches and fame (or at least operating capital and marketplace recognition), not to mention the satisfactions of a mission accomplished.
>
> But then there's the dark side.
>
> What happens after the underwriter has held the closing dinner, after the road show has made its final stop, after investors have, you hope, oversubscribed? There you are, having crossed onto alien turf without a guide. You're public. Suddenly you're being interrogated by pointy-headed strangers, hemmed in by unfamiliar rules, cut off from opportunities you once took for granted. Your company is harder to recognize, and so are the threats to it. The feared result? You'll be out of control. Even if you're still the boss, the company you loved will be gone.
>
> The fears are not farfetched—just check the business pages. Post a bad quarter, and Wall Street crawls all over you; post a couple more, and your own board crawls all over you. Takeover artists woo your shareholders if your stock price sinks (dragging your net worth down with it), and lawyers woo them if there's a misstep in your press releases. You fight back, of course, but all those arcane rules are dictating what you can say, when you can sell, whom you can talk to. And just when you think the trouble is dodged, some analyst gets hold of that confidential memo about the possibility of a $400,000 write-down. "I feel like a squirrel in a carousel," says George Archuleta, chief executive of Vitalink Communications Corp., public since 1988. "I just keep running."

* *

Every once in a while I read a letter somewhere that I can't resist reprinting here. This one appeared a few weeks go in New York magazine. Yeah, it's written by an obviously happy Texan. New Yorkers might read it carefully, it has the ring of truth about it.

> **SO REAL-ESTATE AGENTS IN NEW YORK ARE having trouble selling a 3,500-square-foot apartment for $5 million ["The Great Real Estate Scare of 1990," by Peter Hellman, February 26]. That does not surprise me. I live in a metropolitan area of more than 1 million people in the Sun Belt. My house has 3,500 feet of living space *plus* half an acre of landscaped yard, a 20-by-40-foot swimming pool, and a three-car garage—located on a cul-de-sac in a quiet residential area. Fair market value? Somewhere around $300,000. Of course, such cheap housing has some limitations: I do not pay state or city income taxes, and it snows only once every ten years. Well, I guess you can't have everything!**
>
> *Carlos Pestana, M.D.*
> San Antonio, Tex.

* *

The earth's population is exploding. I worry about it because I have five kids, and I wonder whether they're going to have breathing room when they get older (or if so, whether the air will be worth taking in). I can see what's happening in San Diego. When I moved here from NYC, the town had a population of about 300,000. San Diego's population is well over one million now,

and it's the sixth biggest city in the nation. The freeways here are reaching the bumper-to-bumper stage, and the big open spaces are becoming choked with new homes. And oh yes, we're even getting smog.

* *

How about the rest of the world? The world population is going up 10,000 every hour, 24,000 a day or 90 million a year. Between 1900 and 1950 the world's population increased by one billion to just under 3 billion. Now it's 5.3 billion, and by the year 2000 the world's population will have catapulted to 6 billion.

If you look at a chart of world population growth its exponential, with the chart line now reaching the near-vertical stage (a parabolic curve). I've followed an awful lot of parabolas in the stock market, and they all end up by toppling over and collapsing. If the exponential rise in the earth's population heading for the same fate? If so, what would cause it -- a disease, a nuclear war, world pollution, mass starvation? Or maybe this is the exponential rising curve that will reach the sky.

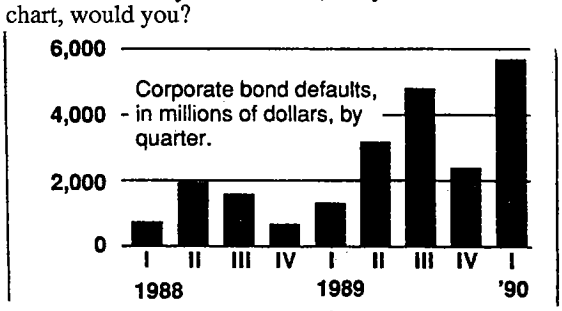
* *

A reminder: I now offer FAX service for Dow Theory Letters. If avoiding the US Post Office and getting instant service interests you, drop us a line, and we'll let you know the cost to FAX your remaining subscription (cost per year is $150).

I also offer the complete history of Dow Theory Letters on microfiche. Thirty-two years of Letters, thousand of pages of charts, comments, market studies and stocks. My life work on a little pile of 4" x 6" films. All for $795.

* *

Mike Milken and junk bonds may have been a blessing for this nation as Milken and many others claim, but you wouldn't know it from this chart, would you?



* *

Well, kiss another mania good bye, and I'm talking about the single country closed-end fund mania of last year. Check these stocks now -- from the Korea Fund to the Taiwan fund, from the German Fund to the Spain Fund. If I'm reading the quotes correctly, you can buy any of 'em at half of last year's frothy peak price (at which time many of them were selling at up to 100% above actual net asset value).

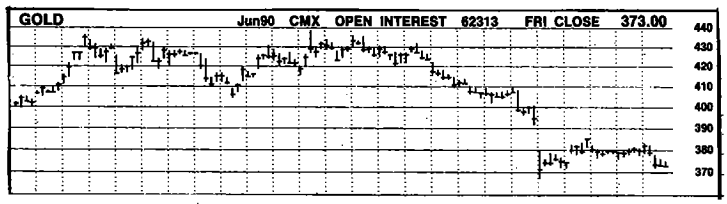
WATCH THEM: Here's an easy way to judge the bear's intentions. Keep your eye on two indices, the S&P 500 and the NYSE Composite. And it's the January lows on these two indices that are important. The January 30 low for the S&P 500 was **322.98.** The January 30 low on the NYSE Composite was **178.43.** I consider these two lows of paramount importance. If they're broken, you can bet this bear means business. Rising (liquidating) volume would heighten the authority of any violation of one or both of these lows.

LATE NOTES & GOLD: There's a titanic battle in progress. Turn to page 3 of this Letter. Study the chart of the Adjusted Monetary Base in the left-hand column, and compare it with the chart of the Debt in the right-hand column. The Debt chart shows you the trend of credit-creation in the nation. We live in a credit economy, and as you can see, credit-growth is collapsing. This trend is strongly deflationary. The Fed obviously sees this ominous picture, and the chart on the left shows you what the Fed is doing about it. What they're doing is trying to pump up the money supply. Can Fed pumping offset slumping credit creation? We don't know -- yet. But the action of the stock market suggests that the Fed may not be able to pump up the money supply fast enough to offset the slump in credit-creation.

In the meantime, to add to the puzzle the CRB Commodity Futures Index closed last week at 245.09, its highest level in a year. This action would ordinarily suggest inflation. Furthermore, consumer price indices throughout the world are pointing up -- towards higher inflation.

So that's the battle -- inflation vs. deflation. Commodities and the CPI (and most everyday consumer prices) are saying inflation, but the stock market is saying deflation or at least deflation in corporate profits.

And then there's the puzzle of gold. If you like inflation, you've got to be discouraged by the action (or inaction) of gold and the precious metals. If inflation is in the wind, if Fed pumping is about to offset the deflationary forces and convert them into inflation, if that's what is about to happen, you don't see it in the action of the metals, at least not yet. (Gold chart courtesy of *Investor's Daily*.)



Of course, there's another problem, and that's the problem of rising interest rates. With high-grade short-term paper yielding over 8% and two-year government paper yielding over 9%, it becomes expensive to hold gold. This is particularly true in a credit-crunch environment, which is about where the US economy is.

If the stock market continues to unravel, the Fed (and probably central banks worldwide) are going to panic. They're then going to lower interest rates and take their chances on inflation. If business starts to cave in (and the stock market suggests that could happen) the Fed is going to open the spigots wide, drop the rates, and fight the business contraction with everything at its command. At that point the inflation will break out into the open -- and gold and the metals will move into a strong bull trend.

The wild card in the picture is DEBT. With the enormous amount of debt built into the economy, the US can't take much of an economic slowdown without the economy sliding off the cliff (it's sitting on the edge of the cliff now). Let interest rates rise (which they're doing), let business decline (which could be about to happen) and debt will act like the jaws of a vice. The big squeeze will be on.

Confidence? In March investors bought a net $3.2 billion in stock mutual funds, a 28% increase over February's purchases and the highest level in three years. That hardly suggests to me that the public is bearish or worried about this market. Also Barron's Confidence Index (based on the relationship between high-grade and medium grade bonds) rose to 98.7 last week, the highest level of the year. That tells me that supposedly sophisticated bond buyers are extremely confident about credit conditions, and they're paying almost no premium for the highest grade bonds over medium grade bonds. Believe me, that is confidence (maybe the bond boys feel the Treasury is going to hold up the world). So is everybody bearish as the experts would have us believe? I'm sure not convinced.

Final comment: DowPow, my proprietary index of the Dow adjusted for the action of the A-D ratio, dropped last week to a new low -- well below the 1987 crash low.

FLASH: Canadian T-bills are very attractive. Merrill Lynch just quoted me 12.70% interest on one month Can. bills, 13.00% on two months, 13.25% on three months. Of course you pay US federal and state taxes on the income, but you still come out far ahead vs. US T-bills. I bought 'em (the Canadian dollar looks OK). NEXT LETTER May 16.